

STATE OF MICHIGAN  
IN THE SUPREME COURT

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Appeal from the Court of Appeals  
(Joel P. Hoekstra, Hilda R. Gage, and Kurtis T. Wilder, JJ.)

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**RANDALL L. ROSS,**

Plaintiff-Appellee,

**Docket No. 130917**

v

**AUTO CLUB GROUP,**

Defendant-Appellant.

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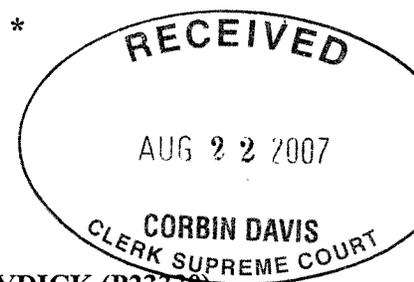
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**APPELLANT'S BRIEF ON APPEAL**

**\*\*\* ORAL ARGUMENT REQUESTED \*\*\***

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## **STATEMENT OF THE BASIS OF JURISDICTION**

This is an appeal, by Defendant Auto Club Group, on leave granted (68a-69a), from the January 3, 2006, opinion of the Court of Appeals in this matter (59a-63a), reconsideration denied March 3, 2006 (64a).

This Court has discretionary by-leave jurisdiction to entertain such appeals. MCR 7.301(A)(2). This Court exercised that jurisdiction by granting, on June 15, 2007, Defendant's timely application for leave to appeal (2a, 68a-69a).

Accordingly, Defendant's appeal is properly before this Court.

**STATEMENT OF THE QUESTIONS PRESENTED**

- I. DID BOTH THE TRIAL COURT AND THE COURT OF APPEALS ERR IN REFUSING TO APPLY THE ESTABLISHED ADAMS v AUTO CLUB INS ASS'N, 154 MICH APP 186 (1986), BENEFIT CALCULATION METHODOLOGY (NET INCOME/LOSS) FOR COMPUTING THE SELF-EMPLOYED PLAINTIFF'S NO-FAULT WORK LOSS BENEFIT ENTITLEMENT?

Defendant-Appellant answers, "Yes."

- II. DID BOTH THE TRIAL COURT AND THE COURT OF APPEALS CLEARLY ERR IN ALSO AWARDING PLAINTIFF MCL 500.3148(1) NO-FAULT-PENALTY ATTORNEY FEES?

Defendant-Appellant answers, "Yes."

## STATEMENT OF FACTS

This is a first-party no-fault personal protection insurance (PIP) benefits breach-of-contract action by Plaintiff Randall Ross against his no-fault insurance carrier, Defendant Auto Club Group (more correctly: Auto Club Insurance Association; hereinafter: “Auto Club”). More specifically, this case is a claim by Plaintiff for MCL 500.3107(1)(b) “work loss” benefits. (47a, 59a).

By motion for MCR 2.116(C)(10) summary disposition (3a-24a), Plaintiff sought disputed MCL 500.3107(1)(b) “work loss” benefits from Defendant Auto Club, as well as an award of MCL 500.3148(1) penalty attorney fees for the Auto Club’s allegedly unreasonable refusal to pay the disputed work loss benefits.

Defendant filed an answer in opposition (25a-37a). In opposing Plaintiff’s motion, the Auto Club relied on the undisputed facts of this case, the expert analysis of an independent certified public accounting firm (Plante & Moran), the applicable statutory provision [MCL 500.3107(1)(b)], and the net profit/loss work loss benefit calculation methodology (for self-employment situations) set forth in Adams v Auto Club Ins Ass’n, 154 Mich App 186 (1986), lv den 428 Mich 869 (1987). It was the Auto Club’s position that the work loss benefits sought by Plaintiff were not owing, and therefore the Auto Club could hardly be deemed unreasonable for not paying them.

Macomb County Circuit Judge Donald Miller heard oral arguments and took the matter under advisement on October 25, 2004 (44a, 47a).

In a 6-page “Opinion and Order” dated December 15, 2004 (47a-52a), the trial court granted Plaintiff’s motion in its entirety and directed that an order of judgment, in conformity with the court’s opinion, be prepared and presented for approval and entry by the court (52a).

Plaintiff prepared and noticed for hearing on March 7, 2005, a proposed judgment. Pursuant to discussions by the parties, the proposed judgment was modified, approved as to form by the parties, and it was entered, as a final judgment, on March 7, 2005. (See “Order Granting Plaintiff’s Motion for Summary Disposition and Taxing Fees and Costs in Accordance with MCLA §§ 500.3142, 500.3148, 600.6013, and 600.2591” – 53a-55a).

The trial court’s March 7, 2005, final judgment (53a-55a) granted Plaintiff’s motion for summary disposition and awarded Plaintiff \$11,277.01 in MCL 500.3107(1)(b) work loss benefits, interest, and costs, as well as \$6,387.50 in MCL 500.3148(1) no-fault penalty attorney fees.

On March 21, 2005, within 14 days of entry of the final judgment (53a-55a) which granted summary disposition and a money judgment to Plaintiff, Defendant Auto Club timely filed its “Motion for Reconsideration and/or Motion for Amendment of Judgment” (1a). The motion was scheduled for hearing on April 4, 2005.

The trial court decided the motion, without a hearing, by an “Opinion and Order” entered March 24, 2005, which denied Defendant’s motion for reconsideration and Defendant’s motion for amendment of judgment (56a-58a).

From the trial court's disposition of this matter, Defendant Auto Club appealed of right to the Court of Appeals (59a). The Auto Club's appellate briefs challenged both of the trial court's determinations (work loss benefits, attorney fees), supra (59a).

On January 3, 2006, the Court of Appeals issued its unanimous published opinion in this matter. Ross v Auto Club Group, 269 Mich App 356 (2006). [59a-63a]. The opinion expressly addressed both disputed issues, supra, and affirmed the trial court's disposition of both issues in favor of Plaintiff and against the Auto Club. The Auto Club timely moved for reconsideration, but the motion was denied by Court of Appeals order entered March 3, 2006 (64a).

On April 13, 2006, Defendant-Appellant Auto Club filed with this Court an Application for Leave to Appeal from the decisions below in this matter (1a). Plaintiff-Appellee filed his Response on May 9, 2006 (2a). The Auto Club filed its Reply on May 30, 2006 (2a).

Defendant's leave-application was denied by order of this Court dated August 29, 2006 (2a, 65a). Ross v Auto Club Group, 476 Mich 865 (2006).

On September 18, 2006, the Auto Club timely filed with this Court a Motion for Reconsideration of this Court's leave-denial order, supra. Plaintiff-Appellee filed his Response on September 25, 2006. (2a).

By order dated December 8, 2006, and amended order dated December 12, 2006, this Court granted Defendant Auto Club's motion for reconsideration, vacated the leave-

denial order of August 29, 2006, reinstated as pending Defendant's leave-application, directed that this matter be scheduled for oral arguments, and ordered the parties to submit supplemental briefs regarding the attorney-fee issue (2a, 66a-67a). Ross v Auto Club Group, 477 Mich 960 (2006).

Supplemental briefs were filed by Defendant-Appellant and Plaintiff-Appellee on January 18 and 19, 2007, respectively (2a). Oral arguments on Defendant's Application were heard by this Court on March 7, 2007 (2a, 68a). By order dated June 15, 2007, this Court granted Defendant's Application and specified additional issues to be briefed by the parties (2a, 68a-69a). Ross v Auto Club Group, 478 Mich 902 (2007).

Pursuant to this Court's grant of leave to appeal (68a-69a), Defendant-Appellant Auto Club submits this Brief on Appeal. In order to avoid repetition, the specific facts pertinent to each issue are included in the respective argument sections, infra.

## ARGUMENT

### I. BOTH THE TRIAL COURT AND THE COURT OF APPEALS ERRED IN REFUSING TO APPLY THE ESTABLISHED ADAMS v AUTO CLUB INS ASS'N, 154 MICH APP 186 (1986), BENEFIT CALCULATION METHODOLOGY (NET INCOME/LOSS) FOR COMPUTING THE SELF-EMPLOYED PLAINTIFF'S NO-FAULT WORK LOSS BENEFIT ENTITLEMENT.

#### A. The nature of the issue

As indicated supra, this case is a claim by Plaintiff for no-fault “work loss” PIP benefits (47a). Such benefits are owed for:

“Work loss consisting of loss of income from work an injured person would have performed during the first 3 years after the date of the accident if he or she had not been injured. . .”

MCL 500.3107(1)(b) [emphasis added].

The issue, then, in this case is: did Plaintiff suffer a § 3107(1)(b) “loss of income from work,” and in what amount?

Plaintiff moved for summary disposition, arguing that he was entitled, as a matter of law, to work loss benefits and in precisely the amount of the “wages” he paid himself (3a-24a). In other words, Plaintiff equated work loss or loss of income from work with lost wages. Defendant answered in opposition (25a-37a), contending that under the undisputed facts, the legal standard (net income/loss analysis) applicable to determining the work loss of a self-employed person, and the evidentiary exhibits supplied by Defendant, the self-employed Plaintiff had in fact suffered no compensable “work loss”

and that there was at least a question of fact regarding that issue.

The trial court heard the motion (38a-46a), took it under advisement (44a), and then granted it (47a-55a). The Court of Appeals affirmed (59a-63a).

Defendant-Appellant Auto Club submits that both courts below erred with regard to the summary disposition of Plaintiff's work loss benefits claim.

This Court has granted leave to appeal on this issue and has directed the parties to address: the appropriate methodology for determining work loss benefits for a Subchapter S corporation owner such as Plaintiff, and the relevance, if any, of both the Subchapter S corporation's profit or loss and the W-2 wages reported by Plaintiff, the S-corporation owner, to the government for income tax purposes (68a-69a) [see "Analysis," infra].

## **B. Standard of Review**

Plaintiff moved for and was granted summary disposition pursuant to MCR 2.116(C)(10) [4a, 9a; 47a, 52a; 59a].

A motion for summary disposition pursuant to C-10 tests the factual sufficiency of the claim. Such a motion can only be granted if there is no genuine dispute of material fact. In deciding the motion and weighing the evidentiary exhibits, all of the proofs and inferences to be drawn from them must be considered in the light most favorable to the non-moving party (here, Defendant). Finally, the trial court's decision to grant or deny (here, grant) summary disposition is reviewed by an appellate court de novo. Maiden v

Rozwood, 461 Mich 109, 118-120 (1999).

### **C. Analysis**

#### **1. The undisputed facts regarding Plaintiff's claim**

In the trial court, there was no dispute that Plaintiff is self-employed. The trial court's opinion stated: "Plaintiff is self-employed and the owner of Michigan Packing Company, Inc." (49a). Plaintiff's business is a Sub-chapter S corporation that has no other paid employees besides Plaintiff himself (21a, 26a, 32a-34a, 59a).

There was also no dispute that, in each of the 3 years (2001-2003) prior to Plaintiff's December 19, 2003, motor vehicle accident, Plaintiff paid himself "wages" ranging from \$11,250.00 to \$16,200.00 (49a-50a).

There was also no dispute that, in each of those 3 preceding years that Plaintiff had paid himself wages, his business operated at a net loss, ranging from \$17,002.00 to \$27,662.00 (49a-50a).

There was also no dispute that, at the time of Plaintiff's accident, his business was continuing to operate at a loss (50a).

The trial court's opinion (47a-52a) noted all of the foregoing undisputed points.

#### **2. The legal standard applicable to Plaintiff's claim**

According to Michigan case law dealing specifically with the issue of "loss of income" and entitlement to "work loss" PIP benefits of a self-employed person, the rule is

clear: a self-employed “plaintiff’s business expenses should be deducted from his gross receipts in determining his lost income.” Adams v Auto Club Ins Ass’n, 154 Mich App 186, 193 (1986), lv den 428 Mich 869 (1987). The Adams Court emphasized: “Certainly, plaintiff cannot claim that his actual expendable income included even that income which he was required to pay out as business expenses” (154 Mich App, at 193).

In arriving at this rule for calculating work loss benefits in self-employment situations, the Adams Court of Appeals panel drew upon the holdings in Coates v Michigan Mut Ins Co, 105 Mich App 290 (1981); McAdoo v United States, 607 F Supp 788 (ED Mich, 1984); and Kamperis v Nationwide Ins Co, 503 Pa 536; 469 A2d 1382 (1983).

The Adams rule, supra – i.e., § 3107(1)(b) work loss or loss of income equals gross income minus expenses – is the unconflicting law or legal standard regarding this Michigan no-fault issue. See also Kerby v Auto-Owners Ins Co, 187 Mich App 552, 555 (1991), citing Adams (“ . . . where the claimant is self-employed, loss of income contemplates the deduction of business expenses.”).<sup>1</sup>

Obviously, if we apply the Adams calculation rule, the result is that Plaintiff would not be entitled to work loss benefits. As a self-employed business owner who paid

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<sup>1</sup> If a person is not self-employed and therefore does not have business expenses to set off from business income, work loss benefits or loss of income from work would be typically paid, per the language of MCL 500.3107(1)(b), in the form of 85% of lost W-2 wages.

himself “wages,” it is nevertheless clear that, for each of the pre-accident years reviewed, Plaintiff’s actual gross receipts were considerably less than his actual expenses, leaving him with a net loss of income rather than a net income. With several years of no pre-accident actual net income, Plaintiff had no post-accident “loss of income from work” to claim.

Defendant Auto Club has steadfastly relied on the Adams rule, supra, in denying Plaintiff’s work loss claim. Plaintiff, on the other hand, ignores his actual gross receipts and business expenses, and argues instead, that, despite his actual net business losses, the “wages” he paid himself each year are dispositive.

### **3. The trial court’s decision**

In granting summary disposition in favor of Plaintiff and against Defendant (52a-54a), the trial court was persuaded by Plaintiff to disregard the Adams rule, supra, and turn instead to a supposedly different or conflicting rule recited by a case in a different jurisdiction: Wilson v State Farm Mut Automobile Ins Co, 934 F2d 261 (CA 10, 1991). [See 48a, 50a-51a].

In order to suggest to the trial court that the Wilson case stated a different and better rule than Adams, Plaintiff gave the court (see 11a-12a) the following quotation excerpt from Wilson which was then adopted and quoted verbatim by the trial court’s opinion (51a):

“ . . . where, as here, the claimant is a sole proprietor, [plaintiff] wears two hats – one as an employee and one as a

business entity. Because the statute provides *individual*, not *business* coverage, it is necessary to calculate the sole proprietor's claim for lost income from her position as an employee. In such case, the proper amount of reimbursement equals that part of the gross income of the business that would have been earned by the [plaintiff] as individual wages.' *Wilson*, at 264. (Emphasis in original.)"

Based on the above quotation, Plaintiff argued and the trial court concluded that Wilson stands for the proposition that, in a self-employment situation, a person is separate from his business and should not have business expenses deducted from income (50a-51a).

However, on closer inspection of Wilson, and utilizing a somewhat larger portion of the opinion for guidance, we find that Wilson actually stands for the opposite proposition:

“The Act is designed to ensure that *persons* injured in automobile accidents are fully compensated for their injuries.’ *Sulzer v. Mid-Century Ins. Co.*, 794 P.2d 1006, 1008 (Colo. 1990) (en banc) (emphasis added). When the claimant is an employee, the gross income lost is equivalent to the amount of salary the claimant would have received had she not been injured. *See Bondi v. Liberty Mut. Ins. Co.*, 757 P.2d 1101, 1102 (Colo. App. 1988) (section 10-4-706 provides for lost wages). However, where, as here, the claimant is a sole proprietor, she wears two hats – one as an employee and one as a business entity. Because the statute provides *individual*, not *business* coverage, it is necessary to calculate the sole proprietor's claim for lost income from her position as an employee. In such case, the proper amount of reimbursement equals that part of the gross income of the business that would have been earned by the claimant as individual wages. To compensate the sole proprietor based upon the gross income generated by the *proprietorship* would be to unfairly

compensate her for business expenses, such as overhead or the salaries of her employees. We believe that a just and reasonable construction of section 10-4-706 mandates the deduction of business expenses from the calculation of lost gross income when the claimant is a sole proprietor.

We agree with State Farm that *Ramirez v. Veeley*, 757 P.2d 160 (Colo. App. 1988), provides strong support for this construction. In *Ramirez*, the Colorado Court of Appeals concluded, without expressly stating its rationale, that ‘loss of gross income per week pursuant to § 10-4-706 must be computed on an individual’s gross income and not on the gross sales or income of the individual’s business.’ *Id.* at 162. A review of other state court cases deciding this issue with respect to their own no-fault PIP auto insurance statutes supports our determination. See, e.g., *Adams v. Auto Club Ins. Ass’n*, 154 Mich. App. 186, 397 N.W.2d 262, 264 (1986) (per curiam) (business expenses should be deducted from gross receipts in determining lost income of self-employed claimant under no-fault act); *Bradley v. Aid Ins. Co.*, 6 Kan. App. 2d 367, 629 P.2d 720, 726 (1981) (no-fault designed to protect claimant’s out-of-pocket losses, rather than losses to her business); *Zyck v. Hartford Ins. Group*, 150 N.J. Super. 431, 375 A.2d 1232, 1233 (1977) (under no-fault statute partner in business owed only for loss of income, not damages measured by value of service to business), *cert. denied*, 75 N.J. 521 384 A.2d 501 (1977). Although it is true that the no-fault statutes construed in the foregoing cases do not modify the term ‘income’ with ‘gross,’ our prior analysis makes clear why this distinction is, for the purposes of personal injury protection insurance, without a difference. We must therefore reverse and remand for a new trial on damages to determine the amount of income that should have been paid by State Farm based on Ms. Wilson’s hourly rate multiplied by the hours she could not work due to her injuries, minus business expenses.”

934 F2d, 263-264 (emphasis added).

When properly quoted, it is clear that Wilson expressly agrees with the Adams

rule, supra, on which the Auto Club relies. Business expenses must be deducted from business income in order to determine a self-employed person's lost income.

Based on the foregoing analysis, the trial court obviously erred in granting summary disposition to Plaintiff with regard to both his entitlement to work loss benefits and the amount of those benefits. There was at least a question of fact as to Plaintiff's entitlement to the benefits. But utilizing an erroneous legal standard, the trial court erroneously decided the PIP benefit dispute as a matter of law, by grant of summary disposition. The trial court was not free to jettison the applicable and controlling legal standard (Adams) and substitute a standard from another jurisdiction (Wilson). And even if it could, the court nevertheless erred by misreading and misapplying that substitute standard which, ironically, was identical to the discarded standard. By post-judgment motion, Defendant pointed out the mistake, supra, with regard to the applicable and controlling legal standard; but the trial court simply berated Defendant, reiterated its ruling, and denied reconsideration (56a-58a).

#### **4. The Court of Appeals decision**

On appeal by Defendant, the Court of Appeals affirmed the trial court's decision to summarily grant Plaintiff's work loss benefit claim, but for a completely different reason.

As indicated supra, the trial court had agreed with the parties that Plaintiff is "self-employed," but the trial court agreed with Plaintiff that Adams and its progeny are inapplicable and that the only measure of Plaintiff's "work loss" or "loss of income from

work” is his W-2 wages.

The Court of Appeals, however, determined that Plaintiff, despite being the sole owner and employee of his Sub-chapter S corporation (59a), was not self-employed, and therefore the Adams net income/loss methodology was distinguishable and not applicable here (61a-62a). The Court of Appeals held that the proper measure of Plaintiff’s work loss was only his W-2 wages because “plaintiff is treated as being in no different position than an employee of any other corporation operating at a loss” (62a).

**5. The Court of Appeals miscomprehended the nature of a Sub-chapter S corporation, the self-employment status of a Sub-chapter S corporation shareholder, and therefore improperly distinguished away, as inappropriate to this case, the Adams self-employment work loss benefit calculation method.**

With all due respect, and for the reasons explained infra, the Court of Appeals’ work loss analysis in this case is fundamentally wrong. The Court of Appeals expressly recognized (59a) that Plaintiff’s business is a Sub-chapter S corporation, but the Court’s analysis overlooked the special self-employment nature of that business entity and simply assumed, expressly and incorrectly, that all corporations and corporate employees are the same. The Court therefore erred in distinguishing away and rendering inapplicable to this case the Adams self-employment work loss benefit calculation method.

§3107(1)(b) work loss benefits are defined as loss of income from work and are

expressly tie-barred to, and inextricably intertwined with, concepts of income taxation and taxable income. That is evident from the language of the statute itself:

“(1) Except as provided in subsection (2), personal protection insurance benefits are payable for the following:

(a) \* \* \*

(b) Work loss consisting of loss of income from work an injured person would have performed during the first 3 years after the date of the accident if he or she had not been injured. Work loss does not include any loss after the date on which the injured person dies. Because the benefits received from personal protection insurance for loss of income are not taxable income, the benefits payable for such loss of income shall be reduced 15% unless the claimant presents to the insurer in support of his or her claim reasonable proof of a lower value of the income tax advantage in his or her case, in which case the lower value shall apply. Beginning March 30, 1973, the benefits payable for work loss sustained in a single 30-day period and the income earned by an injured person for work during the same period together shall not exceed \$1,000.00, which maximum shall apply pro-rata to any lesser period of work loss. Beginning October 1, 1974, the maximum shall be adjusted annually to reflect changes in the cost of living under rules prescribed by the commissioner but any change in the maximum shall apply only to benefits arising out of accidents occurring subsequent to the date of change in the maximum.”

MCL 500.3107(1)(b) (emphasis added). See also Miller v State Farm Mut Auto Ins Co,

410 Mich 538, 562-563 (1981).

The “Sub-chapter S corporation,” a creature of statute,<sup>2</sup> is specifically designed to allow the small business owner (e.g., a sole proprietor or a partnership) to enjoy the benefit of the corporate liability shield while at the same time avoiding the double taxation problem of typical incorporation. In other words, the owner of a Sub-chapter S corporation is shielded from personal liability like a corporation but pays income taxes on the business profits/losses like a sole proprietor or partnership. The ordinary corporate entity (Sub-chapter C corporation) pays income taxes on its profits; then, when those profits are passed along to the owners of the corporation, income taxes are owed again. But with a Sub-chapter S corporation, the corporation does not pay income taxes; the business profits/losses are a direct “pass-through” to the business owners. Rondy, Inc v Comm’r, 1997 US App Lexis 16400 (CA 6; 1997; see attached copy of unpublished opinion – Appendix A, p. 1); Holmes v Dept of Revenue and Taxation, 937 F2d 481, 484 (CA 9, 1991); Metz v Keener, 215 Wis 2d 626, 633; 573 NW2d 865 (1997). See also: Schmidt, Cavitch, Borgsdorf, Michigan Corporation Law, § 3.1, pp. 3-3 to 3-5; 2001 Columbia Bus. L. Rev. 381, 423-424; Kasischke, Michigan Closely Held Corporations, p. 164.

In effect, for purposes of allocating/attributing/taxing business income, Sub-chapter S corporate status rendered Plaintiff Ross’ business the same as a sole

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<sup>2</sup> I.e., the Internal Revenue Code, 26 USC 1361, et seq.

proprietorship. The profits and losses of his business were his; they were a direct pass-through to him. As noted by the Court of Appeals (61a), Plaintiff's corporation is an artificial, separate, recognized legal entity. But the income (net profits/losses) of that corporation is personal to Plaintiff, by the very nature and design of the Sub-chapter S business structure, and as evidenced by Plaintiff's own income tax returns. In other words, while the Court of Appeals respected the "separate existence" of Plaintiff's corporate entity, the Court ignored the special self-employment and income pass-through nature of that particular corporate form.

In an analogous context (attribution of income for purposes of child support laws), the Nebraska Supreme Court, relying on other jurisdictions, specifically held that Sub-chapter S corporation income, etc., is treated just like that of a sole proprietorship. Gase v Gase, 266 Neb 975; 671 NW2d 223, 231 (2003; see attached copy of opinion – Appendix B). The opinion treats a Sub-chapter S corporation owner as being just as self-employed as a sole proprietor or partner (671 NW2d, 230-231). The opinion specifically notes that this treatment of income is in the nature of a Sub-chapter S corporation, and the corporate veil does not have to be pierced (Id.).

For purposes of determining Plaintiff's MCL 500.3107(1)(b) "work loss" benefits or "loss of income from work," there is no reason to exclude his business profits/losses, just as they were included on his tax return. There is nothing in the text of the controlling no-fault statutory provision that would suggest that work loss benefits consist only of

wage losses. There is no reason why the net profit/loss analysis of Adams and its progeny would not apply to Plaintiff Ross and his Sub-chapter S corporation.

In terms of assessing the relevance, to Plaintiff's work loss claim, of his S-corporation's profit or loss, the point is that the corporation's profit or loss is Plaintiff's profit or loss, per the analysis supra. In similarly assessing the relevance of the wages paid by Plaintiff's S-corporation to Plaintiff, those wages are irrelevant and of no use in determining Plaintiff's actual "loss of income." Plaintiff, as S-corporation owner, can pay himself any amount he chooses, and in any form he chooses, and from any source, whether in the nature of business income or borrowed money or money derived from any source whatsoever. The wages could be more than, less than, or equal to his (S-corporation's) net profit. The S-corporation owner could choose to pay himself and report W-2 wages so that he qualifies, irrespective of net profit/loss or actual net taxable income, for Social Security benefit eligibility.

The Court of Appeals was wrong in failing to distinguish Plaintiff's S-corporation from other corporations. Plaintiff is not the same as the employee of any other corporation. He is the sole owner/shareholder/employee of his S-corporation, and that chosen corporate device, by its very nature, directly passes his business profit/loss through to him. Plaintiff is a self-employed person, subjecting him to the work loss calculation methodology set forth in Adams. The net profit/loss methodology of Adams and its progeny is binding precedent that the trial court and the Court of Appeals were

bound to follow. Adams should not have been distinguished; its methodology was just as applicable to the Sub-chapter S corporation owner Plaintiff as it is to a sole proprietor or partner.

At a number of points in its opinion (61a-63a), the Court of Appeals expressed a concern about whether the applicable no-fault policy is an individual or corporate one. That makes absolutely no difference to the computation of Plaintiff's MCL 500.3107(1)(b) work loss entitlement.

The Court of Appeals opinion also repeatedly referred to and relied on Plaintiff not having based his work loss claim on his Sub-chapter S corporation profits/losses but only on the W-2 wages he paid himself (60a-62a). The suggestion is – if Plaintiff didn't, why would Defendant. But why would Plaintiff's self-serving omission of his actual complete income picture control anybody's analysis of Plaintiff's actual "loss of income"?

In sum, the trial court and the Court of Appeals, for starkly different and conflicting reasons, both erred in their resolution of Plaintiff's work loss benefit claim. Worse, the Court of Appeals has misconceived the nature of a Sub-chapter S corporation/owner and, in the instant published opinion (59a-63a), has precedentially bound all such Sub-chapter S work loss cases to be treated like the lost wage claims of "regular" (non-self-employed) corporate employees. This Court needs to intervene to correct this no-fault benefit computational mistake. If, per Ross, and regardless of actual net profit or loss, lost W-2 wages are the bright line test for all work loss benefits claimed

by an S-corporation shareholder/employee, an unprofitable S-corporation owner like Plaintiff will do well indeed because using his “lost wages” as his “loss of income from work” is of course preferable to using his actual business net loss – i.e., preferable to receiving his actual loss of income from work which is zero. But, on the other hand, a profitable S-corporation owner would certainly not want his work loss benefits to be dependent on his arbitrarily set W-2 wages which may not even come close to representing his actual net profit and income.

**II. WHERE THE RECORD OF THIS CASE AND THE DECISIONS OF BOTH COURTS BELOW DEMONSTRATE THAT THERE WAS AT LEAST A LEGITIMATE LEGAL DISPUTE OVER PLAINTIFF'S ENTITLEMENT TO HIS CLAIMED NO-FAULT WORK LOSS BENEFITS, BOTH THE TRIAL COURT AND THE COURT OF APPEALS CLEARLY ERRED IN ALSO AWARDING PLAINTIFF MCL 500.3148(1) NO-FAULT-PENALTY ATTORNEY FEES.**

**A. Introduction**

Because Defendant Auto Club disputed and refused to pay Plaintiff's no-fault work loss personal protection insurance (PIP) benefits claim, the trial court, after awarding Plaintiff his claimed benefits by grant of summary disposition (51a, 53a-54a), penalized the Auto Club by also awarding Plaintiff his attorney fees (51a-52a, 54a-55a), pursuant to §3148(1) of the No-Fault Act, MCL 500.3148(1).

On appeal of right by the Auto Club, the Court of Appeals, in a published precedential opinion,<sup>3</sup> affirmed the trial court with respect to both awards (59a, 63a), including the award of §3148 (1) no-fault penalty attorney fees (62a-63a). Ross v Auto Club Group, 269 Mich App 356 (2006).

The Auto Club respectfully contends that both courts below clearly erred with regard to this no-fault penalty attorney-fee issue.

Indeed, as wrong as the Court of Appeals was with regard to the work loss benefits issue (see Issue I, supra), the Court of Appeals went even farther wrong with the

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<sup>3</sup> MCR 7.215(C)(2) and (J)(1).

disposition of this §3148(1) attorney-fee issue. The Court of Appeals literally mangled the issue. First, the Court of Appeals recognized (61a) that this case involves a no-fault statutory construction issue of “first impression” (i.e., Issue I, supra) that needed to be decided by the instant published opinion. Second, the Court expressly noted (62a) that, according to the applicable established legal standard, no-fault attorney fees are not awardable for “a legitimate question of statutory construction” (i.e., the instant case). But then, the Court of Appeals, in self-contradictory fashion, affirmed the trial court’s award of §3148 attorney fees to Plaintiff (62a-63a). This is plain error that is apparent on the face of the opinion itself. However, unless and until this Court corrects the precedent that is this case, no-fault insurers like Defendant may be punished with § 3148(1) penalty attorney fees even when they dispute a no-fault benefit claim in a situation, as here, of legitimate, first-impression, statutory construction.

This Court has granted the Auto Club leave to appeal regarding this issue and has directed the parties to also brief the (sub-)issue of the standard of review applicable to this issue as well as the (sub-)issue of whether or not there is a valid presumption that an insurer’s refusal or delay in payment of benefits was unreasonable (68a-69a).

#### **B. The legal standards applicable to this issue**

This attorney-fee issue is controlled by statute. §3148(1) of the No-Fault Act provides for awarding a no-fault benefit claimant a reasonable attorney fee as a charge against the insurer but only if the insurer is found to have “unreasonably refused” or

“unreasonably delayed” the payment of the claimed no-fault benefits which have been awarded and determined to be overdue:

“(1) An attorney is entitled to a reasonable fee for advising and representing a claimant in an action for personal or property protection insurance benefits which are overdue. The attorney’s fee shall be a charge against the insurer in addition to the benefits recovered, if the court finds that the insurer unreasonably refused to pay the claim or unreasonably delayed in making proper payment.”

MCL 500.3148(1) [emphasis added]. See also Popma v Auto Club Ins Ass’n, 446 Mich 460, 474 (1994); Proudfoot v State Farm Mut Auto Ins Co, 469 Mich 476, 485 (2003); Moore v Secura Ins, \_\_\_ Mich App \_\_\_ (No. 267191; rel’d 7/3/07).

In Butt v DAIIE, 129 Mich App 211, 220 (1983) (emphasis added), the Court of Appeals recognized that:

“Where a reasonable dispute exists as to either coverage or the amount of benefits owing, the insurer is allowed to contest the claim under the act without penalty.”

According to the numerous decisions interpreting § 3148(1), supra, an insurer’s refusal or delay with regard to making PIP payments will not be deemed “unreasonable” in situations involving a legitimate question of statutory construction (pertinent here), constitutional law, or a bona fide factual uncertainty. See, e.g., Gobler v Auto-Owners Ins Co, 428 Mich 51, 66 (1987); Davidson v Johnson, 79 Mich App 660, 667 (1977); Thomson v DAIIE, 133 Mich App 375, 385 (1984), lv den 422 Mich 862 (1985); United Southern Assurance Co v Aetna Life & Casualty Ins Co, 189 Mich App 485, 492-493

(1991); Hicks v Auto Club Ins Ass'n, 189 Mich App 420, 423 (1991); McCarthy v Auto Club Ins Ass'n, 208 Mich App 97, 102-103, 105 (1994), lv den 450 Mich 921 (1995); Attard v Citizens Ins Co, 237 Mich App 311, 317 (1999); and Rice v Auto Club Ins Ass'n, 252 Mich App 25, 39 (2002). This standard was specifically and expressly recognized by both the trial court and the Court of Appeals in the instant case (51a, 62a).

In other words, just because a no-fault insurer is ultimately deemed to owe some or all of the no-fault benefits claimed, that does not mean that the insurer necessarily owes attorney fees to the claimant. Numerous cases have found such fees inappropriate despite the ultimate underlying determination that no-fault benefits were owing. See, e.g., Gobler v Auto-Owners Ins Co (On Remand), 162 Mich App 717 (1987); DeMeglio v Auto Club Ins Ass'n, 202 Mich App 361, 365 (1993), rev'd on other grds (in favor of insurer) 449 Mich 33 (1995); McCarthy, supra.

Likewise, just because a no-fault insurer is penalized with an award of MCL 500.3142 interest does not mean that the insurer should be further penalized with an award of MCL 500.3148(1) attorney fees. § 3142 interest is an automatic penalty for not paying PIP benefits within 30 days of receipt of reasonable proof of loss; but § 3148(1) attorney fees are not automatic – they are a proper additional charge only if the insurer acted arbitrarily or unreasonably. U of M Regents v State Farm Mut Automobile Ins Co, 250 Mich App 719, 735 (2002).

An insurer's refusal or delay in payment of overdue benefits gives rise to a

rebuttable presumption of unreasonableness that places the burden on the insurer to justify the refusal or delay. See Combs v Commercial Carriers, Inc, 117 Mich App 67, 73 (1982), and its progeny, analyzed infra.

**C. The “presumption” of unreasonableness**

This Court’s leave-grant order in this matter (68a-69a) directed the parties to brief the issue of the validity, or the consistency with MCL 500.3148(1), of the presumption of insurer unreasonableness that was cited, supra, as part of the law applicable to this attorney-fee issue. That presumption is designed to shift the burden of proof. Which party bears the burden of proof is a question of law that is reviewed de novo. Pickering v Pickering, 253 Mich App 694, 697 (2002).

Again, the applicable statutory language reads as follows:

“(1) An attorney is entitled to a reasonable fee for advising and representing a claimant in an action for personal or property protection insurance benefits which are overdue. The attorney’s fee shall be a charge against the insurer in addition to the benefits recovered, if the court finds that the insurer unreasonably refused to pay the claim or unreasonably delayed in making proper payment.”

MCL 500.3148(1).

Basically, this statute says that a no-fault insurer is liable for a no-fault claimant’s reasonable attorney fees for procuring overdue no-fault benefits but only if the trial court finds that the insurer acted “unreasonably” in refusing or delaying payment.

The above-quoted statutory language does not set forth any presumption that the

insurer's refusal or delay in payment was unreasonable. There is not even a suggestion of such a presumption. The language is neutral. The refusal/delay could be reasonable or unreasonable. Liability for attorney fees only arises if the trial court finds insurer unreasonableness.

When the Legislature wants to create a presumption, it has repeatedly demonstrated that it knows how to do so – i.e., it has expressly written the desired presumption into the statute. See, e.g., the MCL 257.401(1) presumption of motor vehicle owner consent, and the MCL 257.402(a) rear-end collision presumption of negligence. Here, in §3148(1), there is no stated or even suggested presumption.

Obviously, if the “presumption” of unreasonableness is not a feature of the statute itself, supra, then it must be a creation of the case law that recognized it and applied it.

The “presumption” appears to have first been invented by the Court of Appeals panel in Combs v Commercial Carriers, Inc, 117 Mich App 67, 73 (1982), lv den 417 Mich 923 (1983):

“Where benefits are not paid within the statutory period [of MCL 500.3142(2)], we think a rebuttable presumption of unreasonable refusal or undue delay arises. It is then the burden of the insurer to explain and justify the refusal or delay. It then becomes the trial court's duty to determine if the refusal or delay is unreasonable. See Wood v DAIIE, 99 Mich App 701, 708; 299 NW2d 370 (1980). This procedure follows logically from the language of the statutory provisions in question.”

(Emphasis added).

The only support cited in Combs for the “presumption” is Wood v DAIIE, supra, and the statutory language itself. But Wood was subsequently reversed in part by this Court in Wood v DAIIE, 413 Mich 573 (1982). And, more importantly, Wood offers no semblance of support for the presumption, and neither does the statutory language itself.

Having simply invented the presumption with no real support, Combs was thereafter relied on for the presumption in Bradley v DAIIE, 130 Mich App 34, 46 (1983); Bloemsma v Auto Club Ins Ass’n, 174 Mich App 692, 696-697 (1989); Borgess Med Ctr v Resto, 273 Mich App 558, 578 (2007); and Moore v Secura Ins, \_\_\_ Mich App \_\_\_ (No. 267191; rel’d 7/3/07; slip opinion, at p. 2). Bloemsma, supra, spawned McKelvie v Auto Club Ins Ass’n, 203 Mich App 331, 335 (1994). McKelvie, supra, was, in turn, cited by Beach v State Farm Mut Auto Ins Co, 216 Mich App 612, 629 (1996); Attard v Citizens Ins Co, 237 Mich App 311, 317 (1999); and Borgess, supra. Beach, supra, was then relied on by Roberts v Farmers Ins Exchange, \_\_\_ Mich App \_\_\_ (No. 270406; rel’d 3/27/07; slip opinion, at p. 6). Attard, supra, was then relied on by Ivezaj v Auto Club Ins Ass’n, \_\_\_ Mich App \_\_\_ (Nos. 265293, 266442, 268137; rel’d 4/24/07), as well as by the Court of Appeals panel in the instant case, Ross, supra, 269 Mich App, at 362-363. And on and on it goes.

The problem with this case-law-generated presumption is that it is not only at odds with the statute, supra, it is also inconsistent with our common law regarding attorney fees.

Under the “American rule,” followed in Michigan, attorney fees are generally only allowed if they are specifically provided for by statute or court rule. Haliw v City of Sterling Hts, 471 Mich 700, 706-707 (2005); Popma v Auto Club Ins Ass’n, 446 Mich 460, 474 (1994). Here, they are specifically provided for by the statute, MCL 500.3148(1).

But statutes such as MCL 500.3148(1) must be narrowly construed:

“Exceptions to the doctrine that attorney fees are not recoverable are narrowly construed.”

Spectrum Health v Grahl, 270 Mich App 248, 253 (2006).

In this instance, the statutory liability for attorney fees has been expanded by a case-law-generated presumption that finds no basis in the statute itself.

Based on the above analysis, the Combs presumption of “unreasonableness” should be retired. Just like any other element of a plaintiff’s cause of action, including the instant no-fault PIP benefits action, the 2-fold burden of proof (going forward and persuasion) regarding a claim for no-fault penalty attorney fees should be on Plaintiff Ross, not Defendant Auto Club. Nasser v Auto Club Ins Ass’n, 435 Mich 33, 49-50 (1990); Widmayer v Leonard, 422 Mich 280, 290 (1985); Borgess Med Ctr, supra, 273 Mich App, at 578-579.

Even with the artificial aid of the Combs presumption, supra, there is no support for the award of §3148(1) attorney fees in this case. The presumption is a “procedural device” (here erroneously) built into the governing legal standards, supra, but it is not

outcome-determinative here. Widmayer, supra, 422 Mich, at 289.

We know from MRE 301 that a rebuttable presumption does not shift the overall (plaintiff) burden of proof/persuasion; it merely shifts the burden of going forward (here, to the defendant). Widmayer, supra, 422 Mich, at 288-291. Once the party to whom the burden has shifted presents any evidence in support of its position, the presumption disappears, and the burden is back on the beneficiary of the presumption to present something. The presumption is only effective if no contrary evidence whatsoever is presented. Krisher v Duff, 331 Mich 699, 705 (1951); Widmayer, supra, 422 Mich, 289; State Farm Mut Auto Ins Co v Allen, 191 Mich App 18 (1991).

As demonstrated in the “Analysis” sub-section, infra (II-E), any burden that Defendant carried in this case, rightfully or wrongfully, was fully satisfied by the Defendant’s submissions which are a matter of record (25a-37a, 60a) and which even the Court of Appeals’ published opinion in this case recognized as constituting a “first impression” issue of no-fault statutory construction (61a).

#### **D. The applicable standard of appellate review**

An award of MCL 500.3148(1) no-fault attorney fees, as in the instant case, generally gives rise to 2 distinct issues: (1) Did the trial court correctly determine that the no-fault insurer acted “unreasonably” and was therefore liable for the plaintiff’s attorney fees? (2) Did the trial court correctly set the amount of the attorney fees by awarding the plaintiff no more than a “reasonable” attorney fee?

Historically, these 2 issues have been subjected to very different standards of review. The attorney-fee liability issue has long been subjected to the “clearly erroneous” standard (see infra). However, in Wood v DAIIE, 413 Mich 573, 588 (1982), this Court subjected the attorney-fee amount issue to the “abuse of discretion” standard. Wood has been followed on this point in subsequent cases. See, e.g., Bradley v DAIIE, 130 Mich App 34, 47-48 (1983); Bloemsma v Auto Club Ins Ass’n, 174 Mich App 692, 697 (1989); Borgess Med Ctr v Resto, 273 Mich App 558, 581 (2007).

In the instant case, we have only the first of these 2 issues. The amount of the attorney fees awarded to Plaintiff is not in controversy. The only issue is the more fundamental or basic one of Plaintiff’s entitlement to, or Defendant’s liability for, any no-fault penalty attorney fees in this case. So, only the standard of review applicable to that particular issue will be explored here.

With regard to the issue of a no-fault insurer’s “unreasonableness” and therefore liability for an award to the Plaintiff of §3148(1) penalty attorney fees, this Court has not specifically addressed the point, but there can be no doubt as to what standard of review has consistently been applied by Michigan Court of Appeals panels to a trial court’s decision to award or deny such fees: the “clearly erroneous” standard. See: Liddell v DAIIE, 102 Mich App 636, 650 (1981); Kalin v DAIIE, 112 Mich App 497, 509 (1982); Butler v DAIIE, 121 Mich App 727, 742 (1982); Butt v DAIIE, 129 Mich App 211, 220 (1983); Bradley, supra, 130 Mich App, at 45; Thomson v DAIIE, 133 Mich App 375,

381, 383 (1984), lv den 422 Mich 862 (1985); Bach v State Farm Mut Auto Ins Co, 137 Mich App 128, 132 (1984); Nelson v DAIIE, 137 Mich App 226, 233 (1984); Joiner v Mich Mut Ins Co, 137 Mich App 464, 479 (1984); Cole v DAIIE, 137 Mich App 603, 613 (1984); Kondratek v Auto Club Ins Ass'n, 163 Mich App 634, 638 (1987); Wright v League Gen Ins Co, 167 Mich App 238, 247 (1988); Bloemsma, supra, 174 Mich App, at 697; Clute v General Accident Assurance Co, 177 Mich App 411, 422 (1989); Conway v Continental Ins Co, 180 Mich App 447, 451-452 (1989); United Southern Assurance Co v Aetna Life & Casualty Ins Co, 189 Mich App 485, 492-493 (1991); McKelvie v Auto Club Ins Ass'n, 203 Mich App 331, 335, 336, 337 (1994), lv den 447 Mich 1000 (1994); McCarthy v Auto Club Ins Ass'n, 208 Mich App 97, 103 (1994), lv den 450 Mich 921 (1995); Beach v State Farm Mut Auto Ins Co, 216 Mich App 612, 628 (1996), lv den 454 Mich 923 (1997); Attard v Citizens Ins Co, 237 Mich App 311, 316-317 (1999); U of M Regents v State Farm Mut Ins Co, 250 Mich App 719, 738, 742 (2002); Rice v Auto Club Ins Ass'n, 252 Mich App 25, 38-39 (2002); Amerisure Ins Co v Auto-Owners Ins Co, 262 Mich App 10, 24 (2004); Borgess, supra, 273 Mich App, at 580; Roberts v Farmers Ins Exchange, \_\_\_ Mich App \_\_\_ (No. 270406; rel'd 3/27/07; slip opinion, at p. 5); Ivezaj v Auto Club Ins Ass'n, \_\_\_ Mich App \_\_\_ (Nos. 265293, 266442, 268137; rel'd 4/24/07); Moore v Secura Ins, \_\_\_ Mich App \_\_\_ (No. 267191; rel'd 7/3/07; slip opinion, at p. 1).<sup>4</sup>

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<sup>4</sup> In Shanafelt v Allstate Ins Co, 217 Mich App 625, 634-636 (1996), the Court of Appeals panel deviated from this pattern and anomalously applied the “abuse of discretion” standard of review.

In light of this nearly uniform line of precedent, the parties in this case argued, and the Court of Appeals decided, this attorney-fee issue on the basis of the “clearly erroneous” standard of review. Ross v Auto Club Group, *supra*, 269 Mich App, at 360, 363-364 (60a, 62a-63a).

However, this Court’s leave-grant order in this case (68a-69a) has itself questioned the applicable standard of review, suggesting other possibilities, and has directed the parties to brief this issue or sub-issue.

In general, Michigan law recognizes 3 basic standards of appellate review: de novo, clear error, and abuse of discretion. These standards differentiate themselves by the amount of deference that they give to the trial court decision under review.

The de novo standard reviews for mere legal error and gives no deference to the judicial decision below. This standard is typically used in reviewing decisions or issues that are purely legal in nature, such as issues of statutory construction, contract interpretation, summary disposition, etc. Herald Co, Inc v Eastern Mich Univ Bd of Regents, 475 Mich 463, 470-472 (2006); Sweebe v Sweebe, 474 Mich 151, 154 (2006); Maiden v Rozwood, 461 Mich 109, 118 (1999).

The “clearly erroneous” standard gives some deference to the trial court. A decision is said to be “clearly erroneous” where although there is evidence to support it, the reviewing court “is left with the definite and firm conviction that a mistake has been made.” Herald, *supra*, 475 Mich, at 471. See also: Kitchen v Kitchen, 465 Mich 654,

661-662 (2002). The “clearly erroneous” standard is typically applied to the review of a trial court’s factual findings. Herald, supra, 475 Mich, at 471-472; Sweebe, supra, 474 Mich, at 154; Tuttle v Dept of State Hwys, 397 Mich 44, 46 (1976).

The abuse of discretion standard is the most deferential to the trial court. Even if the appellate panel questions or disagrees with the trial court’s judgment, the decision below will not be reversed pursuant to this standard unless it “falls outside the principled range of outcomes,” Herald, supra, 475 Mich, at 472, or “so violates fact and logic that it constitutes perversity of will, defiance of judgment or the exercise of passion or bias. . . In short. . . where the court acts in a most injudicious fashion,” Shanafelt, supra, 217 Mich App, at 634-635. This standard of review is typically applied to inherently subjective matters of judgment or discretionary rulings such as those dealing with the admissibility of evidence or the calling of witnesses. Herald, supra, 475 Mich, at 471-472; Craig v Oakwood Hospital, 471 Mich 67, 76 (2004). Other illustrative examples of trial court decisions subject to the abuse of discretion standard are: a decision regarding a motion to amend a pleading, Weymers v Khera, 454 Mich 639, 654 (1997); a decision to grant or deny a motion for new trial, Barnett v Hidalgo, 478 Mich 151, 158 (2007), and People v Lemmon, 456 Mich 625, 648 (1998); a ruling on a motion to set aside a default or default judgment, Alken-Ziegler, Inc v Waterbury Headers Corp, 461 Mich 219, 227 (1999).

This Court has recognized on occasion that a single appellate issue, owing to its complexity or its varied components, may implicate more than a single standard of

review. For example, an issue may be mixed or hybrid, involving a purely legal component, that is subject to de novo review, and a factual or discretionary component, that is subject to a more deferential standard. See, e.g., Sweebe, supra, 474 Mich, at 154. See also People v Lukity, 460 Mich 484, 488 (1999) [an evidentiary decision can involve a preliminary question of law and an ultimate discretionary determination; an error regarding the threshold question can cause the ultimate decision to be an abuse of discretion].

In all probability, the “clearly erroneous” standard, supra, has historically and consistently been assigned to the §3148(1) no-fault attorney-fee issue because of a belief that that issue turns on a trial court determination – i.e., of insurer “(un)reasonableness” – that is essentially factual in nature. For example, in McKelvie, supra, 203 Mich App, at 337 (emphasis added), the Court referred to the “credibility” component of the factual §3148(1) reasonableness issue:

“. . . the trial court, sitting as a fact-finder in determining the reasonableness of ACIA’s refusal to pay, was entitled to decide such issues as credibility.”

More recently, in Griswold Properties, LLC, v Lexington Ins Co, \_\_\_ Mich App \_\_\_ (Nos. 263197, 265278, 268335; rel’d 5/17/07; slip opinion, at p. 12), the Court of Appeals relied on Angott v Chubb Group of Ins Cos, 270 Mich App 465, 477-478 (2006), for the proposition that “. . . whether an insurance claim is reasonably in dispute is a question of fact. . . which this Court reviews for clear error. . .”

However, various federal court decisions construing Michigan law in a similar context (penalty interest) have treated that very same type of reasonableness determination as being a purely legal determination, suitable for summary judgment, and which therefore should more appropriately be subject to de novo review. Kmart Corp v Fireman's Fund Ins Co, 88 FSupp 2d 767, 774 (ED MI, 2000) ["Whether a claim was 'reasonably in dispute' is a matter for the Court to determine . . . Plaintiff has not shown that there is a genuine issue as to a material fact . . . Therefore, the Court will grant summary judgment . . ."]; All American Life & Casualty Co v Oceanic Trade Alliance Council International, Inc, 756 F2d 474, 482 (CA 6, 1985); Board of Trustees of Mich State Univ v Continental Casualty Co, 730 FSupp 1408, 1417 (WD MI, (1990).

Also, under Michigan law, §3148(1) "reasonableness" has a legal definition ("a legitimate question of statutory construction," etc.), supra, that arguably renders that issue legal rather than factual. Indeed, in one §3148(1) decision, this Court utilized the de novo standard for reviewing a slightly different §3148(1) liability issue. In Proudfoot v State Farm Mut Ins Co, 469 Mich 476, 482, 485 (2003), this Court applied the de novo standard as this Court reviewed and reversed a §3148(1) no-fault attorney-fee award. That standard was chosen because this Court deemed the issue of what constitutes §3148(1) "overdue" benefits to be a purely legal issue. However, in Kitchen, supra, where attorney-fee sanctions had been awarded on the basis that the plaintiff had allegedly filed a "frivolous" action, this Court reversed that award under the "clearly

erroneous” standard despite the fact that “frivolous” was a legally-defined term.

And even if the §3148(1) reasonableness issue is a “factual” one, what if all of the pertinent facts are undisputed, thereby rendering the issue, again, a purely legal one, as in the case of review of an MCR 2.116(C)(10) summary disposition ruling. Maiden, supra, 461 Mich, at 118-121.

Defendant-Appellant Auto Club submits that only insofar as the §3148(1) determination of insurer reasonableness might involve a factual or credibility dispute, requiring fact-finding, would the semi-deferential “clearly erroneous” standard be applicable. Where any or all components of the issue involve legal points or matters of undisputed/undisputable fact, the “clearly erroneous” standard is inappropriately deferential and should give way to de novo review. See, e.g., Proudfoot, supra.

With all due respect to the courts below, the herein-alleged and analyzed errors in the §3148(1) determinations of both the trial court and the Court of Appeals in this matter are purely legal and so patent and palpable that they should compel reversal no matter what standard of review this Court ultimately applies to them (see infra).

#### **E. Analysis**

Pursuant to the foregoing legal standards, it is clear that the courts below in this matter erred in awarding Plaintiff MCL 500.3148(1) no-fault penalty attorney fees. Ironically, the trial court’s error in awarding §3148(1) attorney fees is made obvious by the Court of Appeals opinion, even though that opinion affirmed the trial court.

The Court of Appeals precedential opinion in this case (59a-63a) presents an obvious problem, on its face, for anyone who reads that opinion. That fundamental problem is that the Court of Appeals' analysis of the attorney-fee issue is inherently contradictory.

First, we learn from the Court of Appeals opinion that the principal issue in this case (Issue I, supra) is a matter of no-fault statutory construction regarding Plaintiff's entitlement to MCL 500.3107(1)(b) work loss benefits. Ross, supra, 269 Mich App, at 360 (60a).

Second, we learn that this particular work loss benefits issue is a peculiar, problematic, and significant issue because the Plaintiff's status as the sole owner and employee of his own Sub-chapter S corporation raises a question of whether or not Plaintiff is self-employed and therefore subject to the special work loss calculation methodology set forth in Adams v Auto Club Ins Ass'n, 154 Mich App 186 (1986), ly den 428 Mich 869 (1987), and its progeny. Significantly, the Court of Appeals opinion itself labels this work loss statutory construction issue "a question of first impression in Michigan." Ross, supra, 269 Mich App, at 360 (61a); emphasis added.

Third, we observe that the Court of Appeals issues its instructive work loss benefits decision in this case in the form of a published and therefore precedentially binding opinion, a format typically reserved for significant decisions. MCR 7.215.

Fourth, we read the Court of Appeals' recitation of the established standard of

review, supra, for an award of § 3148 no-fault attorney fees. That recitation includes the explicit acknowledgment that no-fault attorney fees are not awardable in situations involving “a legitimate question of statutory construction.” Ross, supra, 269 Mich App, at 363 (62a).

Finally, we learn that the Court of Appeals is affirming, as not clearly erroneous, the trial court’s award of no-fault penalty attorney fees. Ross, supra, 269 Mich App, at 363-364 (62a-63a).

In sum, the Court of Appeals’ opinion explicitly acknowledged that the no-fault work loss PIP benefits issue in this case is a statutory construction issue of first impression, the Court enshrined its decision of that issue in a published opinion, the Court expressly recognized that legitimate questions of statutory construction do not generate or support awards of no-fault penalty attorney fees, but then the Court affirmed the trial court’s award of § 3148(1) attorney fees anyway.

To say that there is a disconnect between the Court of Appeals’ analysis and result is an understatement. In light of the Court of Appeals’ own analysis, the outcome (i.e., affirmance of the attorney-fee award) is an obvious non-sequitur. With all due respect, the Court of Appeals could not have done more to confuse the attorney-fee issue and, via publication, create a problem for future cases. What is most surprising is that the Court’s mistake is so clear, that it is showcased in a published opinion, and that the Court refused to grant reconsideration to correct the obvious problem (64a).

At the risk of flogging the Court of Appeals and this point unnecessarily, there is yet another problem in the Court of Appeals' analysis of this attorney-fee issue. In affirming the trial court's attorney fee award as not clearly erroneous, the Court of Appeals relied on and quoted the trial court's reasoning:

“In awarding attorney fees, the trial court concluded:

‘In the instant case, the evidence clearly indicates that defendant company refused to pay benefits on the basis that because plaintiff was self-employed, and his business was not profitable, he is not entitled to wage loss benefits. Defendant has provided no legitimate justification, no legal authority, no rational or logical arguments in support of that argument. To find that defendant is not liable for attorney fees when it was necessary for plaintiff to litigate in order to obtain benefits to which he was entitled, would defeat the purpose of the no-fault act. It is well-settled that legislation was drafted to award attorney fees in no-fault case so that insurers promptly pay injured parties for reasonable claims. Accordingly, this Court can find no grounds on which to deny plaintiff's request.’

The trial court's determination was not clearly erroneous. . .”

Ross, supra, 269 Mich App, at 363 (emphasis added) (62a).

While this explanation does not in any way negate or overcome the obvious analytical error explained supra, this quoted analysis and the Court of Appeals' adoption of it demonstrates yet a further error or contradiction.

In light of the record of this case, it absolutely defies logic for either the trial court

or the Court of Appeals to say that the Auto Club “provided no legitimate justification, no legal authority, no rational or logical arguments” in support of its dispute/denial of Plaintiff’s work loss claim.

This Court has the record of this case. In the Appellant’s Appendix is the Auto Club’s answer, brief, and exhibits (25a-37a) in opposition to Plaintiff’s motion for summary disposition (3a-24a), as well as the trial court motion hearing transcript (38a-46a) and the opinion and order of the trial court (47a-52a). Just based on those record documents alone, we see that the Auto Club, in making its case in the trial court, expressly relied on: (1) the undisputed facts of this case; (2) the expert analysis of an independent certified public accounting firm (Plante & Moran); (3) the applicable statutory provision [MCL 500.3107(1)(b)]; and (4) the net profit/loss work loss benefit methodology set forth in Adams, supra.

Whatever the courts below thought of the Auto Club’s position on the work loss issue, it is neither accurate, nor honest, nor logical to say that the Auto Club provided nothing – no justification, no legal authority, no rational or logical argument – in support of its position. The very factors, supra, relied on by the Auto Club are recognized, analyzed, and even distinguished in both the trial court and Court of Appeals opinions themselves. Again, we have a non-sequitur.

Ironically, the trial court’s opinion (47a-52a) spent much of its 6 pages explaining why it didn’t like the Auto Club’s reliance on Michigan law (Adams, supra) and why it

therefore felt that it was necessary to rely instead on a Tenth Circuit federal decision [Wilson v State Farm Mut Auto Ins Co, 934 F2d 261 (CA 10, 1991)] which the trial court (mistakenly) thought was at odds with Adams (see Issue I, supra). Ironic, too, is the fact that the Court of Appeals analyzed and then distinguished away Adams and its progeny – i.e., the legal standard relied on by the Auto Club. If there was nothing legitimate, legal, rational, or logical about the Auto Club’s arguments, why then did the trial court and the Court of Appeals spend so much time analyzing and rejecting or distinguishing the Auto Club’s legal authority and position, ultimately in a published opinion showcasing a statutory construction issue of “first impression.”<sup>5</sup>

#### **F. Summary of Argument**

It is clear from the record of this case and the applicable legal standards that the decisions of both courts below in this matter were erroneous with regard to awarding Plaintiff MCL 500.3148(1) no-fault penalty attorney fees. The trial court awarded Plaintiff his §3148(1) attorney fees on the basis that the Auto Club had not paid Plaintiff his claimed work loss benefits and that the Auto Club had allegedly presented absolutely nothing in the way of support or justification for that action. The trial court was wrong, as demonstrated by even the court’s own opinion which referred to and distinguished

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<sup>5</sup> In Popma v Auto Club Ins Ass’n, 446 Mich 460 (1994), another case dealing with a MCL 500.3107(1)(b) work loss benefits issue of “first impression” (446 Mich, 467), this Court noted that there was no finding by the trial court (or anyone) that the insurer had acted unreasonably so as to entitle the plaintiff to his §3148(1) attorney fees (446 Mich, 474). There should have been no such finding in the instant case as well.

away everything the Auto Club had in fact argued and submitted. The Court of Appeals compounded the error by incongruously affirming the trial court's attorney-fee award while at the same time recognizing, in a published opinion, that the issue raised by the Auto Club's handling of Plaintiff's work loss benefit claim was a no-fault statutory construction issue of "first impression."

**RELIEF**

For all of the foregoing reasons, Defendant-Appellant Auto Club requests that this Honorable Court reverse the January 3, 2006, decision of the Court of Appeals (59a-63a) with regard to both issues on appeal, vacate the orders of the trial court that granted summary disposition and judgment in favor of Plaintiff-Appellee (47a-55a), and remand this matter to the trial court for further proceedings.

Respectfully submitted,

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Dated: August 22, 2007

A

1997 U.S. App. LEXIS 16400, \*; 97-2 U.S. Tax Cas. (CCH) P50,546;  
80 A.F.T.R.2d (RIA) 5139

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**RONDY, INC., Petitioner-Appellant, v. COMMISSIONER OF INTERNAL  
REVENUE, Respondent-Appellee.**

**No. 95-2259**

**UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT**

*1997 U.S. App. LEXIS 16400; 97-2 U.S. Tax Cas. (CCH) P50,546; 80 A.F.T.R.2d  
(RIA) 5139*

**July 1, 1997, FILED**

**NOTICE:** [\*1] NOT RECOMMENDED FOR FULL-TEXT PUBLICATION. SIXTH CIRCUIT RULE 24 LIMITS CITATION TO SPECIFIC SITUATIONS. PLEASE SEE RULE 24 BEFORE CITING IN A PROCEEDING IN A COURT IN THE SIXTH CIRCUIT. IF CITED, A COPY MUST BE SERVED ON OTHER PARTIES AND THE COURT. THIS NOTICE IS TO BE PROMINENTLY DISPLAYED IF THIS DECISION IS REPRODUCED.

**SUBSEQUENT HISTORY:** Reported in Table Case Format at: *117 F.3d 1421, 1997 U.S. App. LEXIS 24072.*

**PRIOR HISTORY:** ON APPEAL FROM THE UNITED STATES TAX COURT. 94-04325. 8-9-95.

**DISPOSITION:** AFFIRMED.

**JUDGES:** BEFORE: GUY, RYAN and COLE, Circuit Judges.

**OPINION:**

**PER CURIAM.** Petitioner Rondy, Inc. ("Rondy") appeals the decision of the United States Tax Court affirming the deficiency determination of the Commissioner of Internal Revenue Service ("Commissioner"). For the following reasons, we affirm the Tax Court's decision.

**I.**

In 1987 and 1988, Rondy, an Ohio corporation subject to taxation under Subchapter C of the Internal Revenue Code, made two adjustments to its method of accounting that required Rondy to recognize additional income ("the section 481(a) adjustments"). *See 26 U.S.C. § 481(a).* In 1987, Rondy changed its method of accounting from the "modified accrual method" -- a

method of accounting not approved by the Internal Revenue Code, regulations or the United States [\*2] Supreme Court -- to an authorized accounting method known as the "accrual method." As a result of this change, Rondy was required to recognize approximately \$ 1,364,433 additional income over a period of three years; thus, Rondy was required to report \$ 454,811 additional income in fiscal years 1989, 1990, and 1991. *See 26 U.S.C. § 481(a); Rev. Proc. 85-36, 1985-2 C.B. 434.* Then, in its fiscal year ending June 30, 1988, Rondy changed its accounting treatment of inventory from the "full absorption method" to the "uniform capitalization method," requiring Rondy to recognize \$ 7,603 additional income over a period of four years. *See 26 U.S.C. §§ 263A, 481(a).* Rondy was required to report \$ 1,901 in fiscal years 1989, 1990, 1991, and 1992.

Effective July 1, 1988, Rondy elected to convert from a "C corporation" (a corporation taxed under Subchapter C of the Internal Revenue Code) to an "S corporation" (a corporation taxed under Subchapter S of the Internal Revenue Code). Whereas a C corporation is liable for tax on its income and its shareholders are potentially subject to an additional tax on corporate distributions to them, an S corporation pays no income tax; rather, an S corporation's [\*3] shareholders pay tax on the S corporation's income as if they earned the income directly. *See 26 U.S.C. § 1361-1379.*

In fiscal year 1989, Rondy included the section 481(a) adjustments in its S corporation income. Accordingly, Rondy itself paid no tax on the adjustment amounts, but instead passed the income directly to its shareholders. Rondy had submitted its applications to the Internal Revenue Service to change its accounting methods in 1987 and its fiscal year ending June 30, 1988, but was permitted to spread its section 481(a) adjustments over a period of years, from 1989 to 1992, in order to avoid the burden of paying the entire amounts in the year of change. *See 26 U.S.C. § 481(c)* (permitting

taxpayers to take their section 481(a) adjustments into account "in such manner and subject to such conditions as the Secretary may by regulations prescribe . . ."). Although Rony applied to the Internal Revenue Service to change its accounting methods while it was still operating as a C corporation, its election of S status in its fiscal year ending June 30, 1989 resulted in the section 481(a) adjustments being made in years after it had already started operating as an S corporation. [\*4]

In 1993, the Commissioner issued a notice of deficiency to Rony for fiscal year 1989, claiming that Rony's conversion to an S corporation did not relieve it of the duty to pay an additional, corporate-level tax on its section 481(a) adjustments. Pursuant to 26 U.S.C. § 1374, a corporation that has converted from a C to an S corporation may be held liable for a "built-in gains" tax on any items of income attributable to the period before the S election was made. Because Rony had made the section 481(a) adjustments while it was still a C corporation, the Commissioner determined that Rony was liable for the built-in gains tax on the amount of those adjustments. Rony petitioned the Tax Court for review of the Commissioner's deficiency determination. On August 8, 1995, the Tax Court held that Rony was liable for the additional tax.

Rony has timely appealed the decision of the Tax Court.

## II.

We review the Tax Court's conclusions of law *de novo*. *Walter v. Commissioner*, 753 F.2d 35, 38 (6th Cir. 1985); *see also Peoples Federal Sav. and Loan Ass'n of Sidney v. Commissioner*, 948 F.2d 289, 294 (6th Cir. 1991); 26 U.S.C. § 7482.

## III.

Rony contends that the Tax [\*5] Court erred in affirming the Commissioner's deficiency determination. Specifically, Rony argues (1) that section 481(a) adjustments do not constitute items of income subject to the built-in gains tax under 26 U.S.C. § 1374(d)(5)(A); and (2) that the Commissioner's deficiency determination was based on an improper, retroactive application of *Treasury Regulation 1.1374-4(D)*. We disagree.

An S corporation is subject to the built-in gains tax on any item of income which is attributable to the period before its S election was made, but which is properly taken into account only after the S election. *See* 26 U.S.C. § 1374(d)(5)(A). Pursuant to 26 U.S.C. § 1374(a), an S corporation is subject to tax on its net "recognized built-in gain." "Recognized built-in gain" is any gain an S corporation recognizes on the disposition

of an asset within ten years of its conversion from a C to an S corporation. *See* 26 U.S.C. § 1374(d)(3). Although this section refers only to gain on the "disposition of [an] asset," Congress clarified that the term includes not only the sale or exchange of an asset, but also several "other income recognition events. . . ." *See* H.R. Rept. No. 100-795, at [\*6] 63 (1988) (clarifying that the term "disposition of any asset" could also include "other income recognition events" such as the conversion of a cash basis personal service corporation to S corporation status; noting that any receivables held by the corporation at the time of its conversion would be built-in gain items when received). Specifically, Congress explained that "any item of income properly taken into account [after the S election was made, but attributable to the period before the S election,] shall be treated as recognized built-in gain for the taxable year in which it is properly taken into account." 26 U.S.C. § 1374(d)(5)(A). Thus, Rony was required to pay the built-in gains tax on any item of income attributable to the period it was operating as a C corporation, but which was not properly taken into account until after it had elected S status. *See* 26 U.S.C. § 1374(d)(5)(A).

In the present case, Rony's section 481(a) adjustments clearly constitute "item[s] of income" within the meaning of 26 U.S.C. § 1374(d)(5)(A) and, thus, are subject to the built-in gains tax. *See* 26 U.S.C. § § 1374(a), (d)(5)(A). For fiscal years 1989, 1990, 1991, and 1992, Rony was [\*7] required to include in its taxable income the amount of its section 481(a) adjustments. *See* 26 U.S.C. § 481(a)(2). Accordingly, in calculating its taxable income for fiscal year 1989, Rony included \$ 454,811 for its change to the accrual method and \$ 1,901 for its change in its inventory method. As the Tax Court noted, Rony's section 481(a) adjustments were made to prevent those items from being omitted from its income as a C corporation. *See* 26 U.S.C. § 481(a)(2) ("In computing the taxpayer's taxable income, there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change [in accounting method] in order to prevent amounts from being duplicated or omitted [from the amount of taxable income]."). In fact, if Rony had been using an appropriate accounting method during its years as a C corporation, the amount now subject to the built-in gains tax as a result of its change to the accrual method (\$ 454,811) would have been taxed in earlier years, while Rony still operated as a C corporation and was subject to corporate income tax. Rony attempted to avoid the corporate income tax it would have paid on the amount of [\*8] its section 481(a) adjustments by electing S status immediately after it had made the adjustments. However, considering that the section 481(a) adjustments

increased Rondy's taxable income, we believe that they constituted "item[s] of income" within the meaning of 26 U.S.C. § 1374(d)(5)(A). Because those items of income were attributable to the period of time that Rondy was operating as a C corporation, but were not properly taken into account until Rondy had elected S status, n1 the items constitute recognized built-in gain subject to taxation under 26 U.S.C. § 1374(a).

n1 Although Rondy applied to the Internal Revenue Service to change its accounting methods while it was still operating as a C corporation, its election of S status in its fiscal year ending June 30, 1989 resulted in the section 481(a) adjustments being "properly taken into account" in years after it had already started operating as an S corporation.

Next, Rondy argues that the Tax Court erred in affirming the Commissioner's deficiency determination [\*9] because the Commissioner's determination was based on an improper, retroactive application of *Treas.*

*Reg. § 1.1374-4(d)*. Pursuant to that regulation, "any section 481(a) adjustment taken into account in the [ten years following an S election] is recognized built-in gain or loss to the extent the adjustment relates to items attributable to periods before the [S election] . . ." See *Treas. Reg. § 1.1374-4(d)*. Rondy correctly points out that this regulation was not effective until December 27, 1994, and argues that the deficiency determination assessed against it constituted a retroactive application of the regulation's provisions. However, the Commissioner has never contended that *Treas. Reg. § 1.1374-4(d)* governs Rondy's tax liability and we have held that, even without reference to the regulation, that section 481(a) adjustments can constitute "recognized built-in gain" within the meaning of 26 U.S.C. § 1374(a). See *Knetsch v. United States*, 364 U.S. 361, 367, 5 L. Ed. 2d 128, 81 S. Ct. 132 (1960); *Jewett v. Commissioner*, 70 T.C. 430, 438-39 (1978), *aff'd*, 638 F.2d 93 (9th Cir. 1980), *aff'd*, 455 U.S. 305, 71 L. Ed. 2d 170, 102 S. Ct. 1082 (1982). Accordingly, [\*10] Rondy's contention is meritless.

#### IV.

For the foregoing reasons, we **AFFIRM** the judgment of the Tax Court.

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Theresa Ann Gase, appellant and cross-appellee, v. John Charles Gase, appellee and cross-appellant.

No. S-02-1115.

## SUPREME COURT OF NEBRASKA

266 Neb. 975; 671 N.W.2d 223; 2003 Neb. LEXIS 175

November 14, 2003, Filed

**PRIOR HISTORY:** [\*\*\*1] Appeal from the District Court for Sarpy County: Ronald E. Reagan, Judge.

**DISPOSITION:** Affirmed in part, and reversed in part; remanded with directions.

**HEADNOTES:** 1. **Modification of Decree: Child Support: Appeal and Error.** Modification of child support payments is entrusted to the trial court's discretion, and although, on appeal, the issue is reviewed de novo on the record, the decision of the trial court will be affirmed absent an abuse of discretion.

2. **Judges: Words and Phrases.** A judicial abuse of discretion exists when a judge, within the effective limits of authorized judicial power, elects to act or refrain from action, but the selected option results in a decision which is untenable and unfairly deprives a litigant of a substantial right or a just result in matters submitted for disposition through a judicial system.

3. **Child Support: Rules of the Supreme Court: Appeal and Error.** Interpretation of the Nebraska Child Support Guidelines presents a question of law, regarding which an appellate court is obligated to reach a conclusion independent of the determination reached by the court below.

4. **Modification of Decree: Child Support: Proof.** A party seeking to modify a child support order must show a material change in circumstances which has occurred subsequent to the entry of the original decree or a previous modification and was not contemplated when the decree was entered.

5. **Taxation: Corporations: Words and Phrases.** Subchapter S is a tax status designed to tax corporate income on a pass-through basis to shareholders of a small business corporation.

6. **Child Support: Corporations: Parent and Child.** While an S corporation is a separate legal entity, for purposes of calculating child support, an S corporation's income and expenses are attributable to the parent.

7. **Child Support: Rules of the Supreme Court: Taxation.** Paragraph D of the Nebraska Child Support Guidelines provides that if a party is self-employed, depreciation claimed on tax returns should be added back to income or loss from the business or farm to arrive at an annualized total monthly income. Income for the purpose of child support is not synonymous with taxable income.

8. **Child Support: Rules of the Supreme Court: Partnerships.** The Nebraska Child Support Guidelines do not limit "self-employed" persons to sole proprietorships or partnerships.

9. **Child Support: Rules of the Supreme Court: Corporations.** The owner of a wholly owned S corporation is self-employed within the meaning of the Nebraska Child Support Guidelines.

10. **Divorce: Modification of Decree: Child Support.** The paramount concern and question in determining child support, whether in the initial marital dissolution action or in the proceedings for modification of decree, is the best interests of the child.

11. **Supreme Court: Administrative Law: Judicial Notice.** The Nebraska Supreme Court will take judicial notice of general rules and regulations established and published by Nebraska state agencies under authority of law.

12. **Supreme Court: Administrative Law: Judicial Notice.** The Nebraska Supreme Court will take judicial notice of rules and regulations established and published by federal agencies under authority of law.

**13. Child Support: Rules of the Supreme Court: Pensions.** The Nebraska Child Support Guidelines do not allow a deduction for contributions to retirement plans in excess of the minimum amount required by the plan for purposes of calculating child support.

**14. Child Support: Rules of the Supreme Court.** Paragraph D of the Nebraska Child Support Guidelines defines total monthly income as the income of both parties derived from all sources, except all means-tested public assistance benefits and payments received for children of prior marriages.

**COUNSEL:** Michael D. Gooch for appellant.

Angela L. Burmeister and Christian R. Blunk, of Berkshire & Blunk, for appellee.

**JUDGES:** Hendry, C.J., Wright, Connolly, Gerrard, McCormack, and Miller-Lerman, JJ. Stephan, J., not participating.

**OPINIONBY:** McCormack

**OPINION:**

[\*\*226] [\*976] McCormack, J. NATURE OF CASE

This is an appeal from an order modifying a divorce decree awarding child support. Theresa Ann Gase filed a petition for modification of decree, seeking to modify the support being paid by John Charles Gase for the minor children of the parties. The [\*977] district court for Sarpy County entered an order increasing John's monthly support obligation. Theresa appeals the trial court's order. She claims that the trial court erred in calculating the parties' respective incomes, in incorrectly crediting John twice for the children of his second family, and in failing to retroactively apply the modification of child support. John cross-appeals, contending that the trial court erred in failing to add depreciation claimed on Theresa's federal income tax returns back to her income. [\*\*\*2]

**BACKGROUND**

Theresa and John are the parents of two children born July 3, 1983, and October 19, 1984. Their marriage was dissolved by a decree entered in the district court for Sarpy County. The decree awarded custody of the parties' minor children to Theresa with reasonable visitation to John. The decree further ordered John to pay child support in the sum of \$175 per month for each child, for a total of \$350 per month. John subsequently remarried; has two children with his current spouse, which children are ages 12 and 4; and lives in Texas. Theresa later filed an appli-

cation for modification and, following a hearing on the application, the trial court entered an order modifying the decree. The modification order found that Theresa's net monthly income was \$5,200 and that John's net monthly income was \$2,800. Finding that there had been a material change in circumstances since entry of the original decree, the trial court ordered John to pay monthly child support of \$675 for two children and \$450 for one child.

On September 13, 2001, Theresa again filed a petition for modification of decree, seeking an increase of John's child support obligation. The petition indicates that [\*\*\*3] it was sworn and subscribed to and served upon John by U.S. mail on April 23, 2001. At or around that time, John signed an undated voluntary appearance. John contends on appeal that the first notice he received that Theresa actually filed the petition for modification was early February 2002, when he received notice from the court that a hearing date had been set. The hearing date had been set for March 20. The record does not reveal whether [\*\*227] John and Theresa had any additional discussions regarding the petition for modification between the time John signed the voluntary appearance in [\*978] approximately April 2001 and the time he learned of the hearing date in approximately February 2002. John's attorney entered her appearance in the matter on February 13. On February 14, John answered and filed a cross-petition requesting a decrease in his child support obligation. On April 22, John sought to continue the hearing originally set for April 25 for the reason that he had not received all responses to discovery. On May 15, Theresa served supplemental documents in reply to John's requests for production of documents.

An evidentiary hearing was held on May 23, 2002, at which John and his current [\*\*\*4] wife's federal income tax returns for the years 1999 through 2001 were offered and received into evidence. John's 2001 W-2 wage and tax statement was also offered and received into evidence. Box No. 1 on John's 2001 W-2, entitled "Wages, tips, other compensation," reported income of \$72,441.20. Box No. 12a of John's 2001 W-2 reported an undescribed dollar figure not otherwise included in box No. 1 in the amount of \$9,509.20. Also offered and received into evidence was a copy of John's most current pay stub for the period ending March 31, 2002, which pay stub reported year-to-date earnings of \$24,858.40. In addition to contributions made to a 401K and a flexible spending account, the pay stub also reflected current and year-to-date FICA payments. John's wife's monthly gross income in 2001 was \$2,800.

Theresa is an attorney and is the sole shareholder of several corporations organized under subchapter S (S corporations): Lone Star Solutions, Inc.; Gase Technologies,

Inc.; Peel Country, Inc.; and Gase and Associates. See I.R.C. § 1361(a)(1) (2000). Theresa's federal income tax returns for the years 1998 through 2001 and selected accompanying schedules were [\*\*\*5] offered and received into evidence. The returns reported total income of \$112,128 in 1998, \$95,300 in 1999, and \$127,134 in 2001. The 2000 return reported a \$48,210 loss. The record reveals that Theresa received W-2 wage and tax statements from Gase Technologies for 1998 and 1999 and from Lone Star Solutions for 2001. Theresa's 1999 W-2 reported the amount of \$89,090.76 in box No. 1, "Wages, tips, other compensation," and an undescribed amount in box No. 13 of \$7,800. While it is not clear from the record whether the \$7,800 was also included [\*979] in the box No. 1 income, the 1999 W-2 contains a section providing a summary listing of Theresa's income adjustments. This summary reported "EE 401K" deferrals of \$7,800, which presumably describes the nature of the amount listed in box No. 13. The 2001 W-2 reported the amount of \$32,199.96 in box No. 1, "Wages, tips, other compensation." Box No. 12a reported an undescribed dollar figure not otherwise included in box No. 1 in the amount of \$2,799.94.

Theresa's federal income tax returns reported a \$44,887 capital gain in 1999 and a \$3,000 capital loss in each of the years 2000 and 2001. No capital gain or loss activity was reported [\*\*\*6] in 1998.

Theresa's returns also reported deductions taken for both personal and business depreciation. On her 1999 personal federal income tax return, Theresa took depreciation deductions for rental real estate she personally owned and depreciation associated with Peel Country and Gase Technologies. On her 2000 personal federal income tax return, Theresa took depreciation deductions associated with Lone Star Solutions and Peel Country. Theresa's 2001 personal federal income tax return reported depreciation deductions for her personally owned rental real estate, depreciation [\*\*228] associated with Peel Country, and depreciation deductions pursuant to I.R.C. § 179 (2000). Our review of the record reveals that Theresa may have taken additional depreciation deductions not otherwise reflected in the record on appeal.

John offered two proposed worksheets, both of which were received into evidence. The first proposed worksheet 1 calculated John's child support obligation to the two children of his current family at \$1,006. The worksheet reflected his income and that of his current wife and reported deductions for federal and state income taxes and FICA. The worksheet also [\*\*\*7] deducted from John's income \$491 for "Child Support Previously Ordered" (presumably with respect to the two children from his first family). The second proposed worksheet 1 calculated

John's child support obligation to the two children of his first family. This worksheet listed Theresa's monthly income and reported the same income and deductions for John as appeared on the first proposed worksheet 1, with one exception. The \$491 for "Child Support Previously Ordered" appearing on the first proposed worksheet 1 was replaced with the calculated child support obligation of [\*980] \$1,006. The second proposed worksheet calculated John's child support obligation at \$522.80 for two children. Theresa's proposed worksheet 1 was not received into evidence on lack of foundation and hearsay grounds.

On June 4, 2002, the trial court issued a letter to counsel for the parties resolving the issues before it. With respect to Theresa's income, the court was not convinced that there had been a change upward or downward. Specifically, the court was not persuaded by Theresa's contention that she had sustained a significant reduction in income. Nor was the court persuaded by John's argument that depreciation, [\*\*\*8] when added back in, would show a sizable increase in Theresa's income. Accordingly, for purposes of calculating child support, the trial court indicated it would rely on the finding in the previous modification decree and keep Theresa's monthly income at \$5,200. The trial court found that John's income had increased substantially, but noted he was entitled to a deduction for support attributed to the two children of his second family. The court applied a three-step process to determine John's child support obligation to the children of his first family. It is helpful here to quote directly from the trial court's June 4 letter:

The first step is to calculate [John's] child support obligation as to his present family, recognizing there is no divorce in process. [John] and his wife live in the state of Texas and so the state income taxes should be added back in to their net income. In [the first proposed worksheet 1, John's counsel] allowed a deduction of \$491 for child support previously ordered - in reality, this figure should be \$675. When I round the figures off, the Child Support Guidelines show [John's] obligation for his present family to be the sum of \$1,026.

Next, [\*\*\*9] using the \$5,200 per month as a net income for [Theresa], and a net income for [John] of \$3,300 (a gross of approximately \$6,035 with the deductions including the \$1,026), [John's] support for two children of his first marriage would be \$755 and, for one child, the sum of \$520. This equates to

a total support of four children in an approximate amount of \$1,780. The last step is to apportion this between the two families. This would then require [John] to [\*981] pay the sum of \$890 as child support for the two children of his first marriage.

The trial court issued its order on August 26, 2002, which repeated the terms of [\*\*229] its June 4 letter and also added a provision ordering John to pay the modified child support commencing on June 1, 2002. Neither the June 4 letter nor the order included a completed worksheet 1. Theresa appealed, and John cross-appealed. We moved the case to our docket pursuant to our authority to regulate the caseloads of this court and the Nebraska Court of Appeals. See Neb. Rev. Stat. § 24-1106(3) (Reissue 1995).

#### ASSIGNMENTS OF ERROR

Theresa assigns, restated and renumbered, that the trial court erred by (1) failing [\*\*\*10] to prepare and attach worksheet 1 to its findings or order; (2) incorrectly determining the amount of John's income when it used his 2001 income rather than his 2002 projected annual income; (3) incorrectly determining the amount of John's income by failing to take into account other income listed on John's 2001 W-2 wage and tax statement; (4) incorrectly determining the amount of her income and that it had not materially changed when it included a "one-time" capital gain she earned in 1999; (5) incorrectly crediting John twice for the children of his second family, resulting in substantially more support being provided to said children than for the children of his first family; and (6) failing to apply the modification of child support retroactively to the first day of the month following the filing date of the petition for modification.

John assigns, on cross-appeal, that the trial court erred by failing to add depreciation claimed on Theresa's federal income tax returns back to her taxable income for the purpose of calculating child support.

#### STANDARD OF REVIEW

[1, 2] Modification of child support payments is entrusted to the trial court's discretion, and although, on appeal, [\*\*\*11] the issue is reviewed de novo on the record, the decision of the trial court will be affirmed absent an abuse of discretion. *Erica J. v. Dewitt*, 265 Neb. 728, 659 N.W.2d 315 (2003); *Peter v. Peter*, 262 Neb. 1017, 637 N.W.2d 865 (2002). A judicial abuse of discretion exists [\*982] when a judge, within the effective limits of authorized judicial power, elects to act or refrain from action, but the selected option results in a decision which is untenable and unfairly deprives a litigant of a

substantial right or a just result in matters submitted for disposition through a judicial system. *Noonan v. Noonan*, 261 Neb. 552, 624 N.W.2d 314 (2001).

[3] Interpretation of the Nebraska Child Support Guidelines presents a question of law, regarding which an appellate court is obligated to reach a conclusion independent of the determination reached by the court below. See *Gallner v. Hoffman*, 264 Neb. 995, 653 N.W.2d 838 (2002).

#### ANALYSIS

[4] A party seeking to modify a child support order must show a material change in circumstances which has occurred subsequent to the entry of the original decree or a previous modification and was [\*\*\*12] not contemplated when the decree was entered. *Gammel v. Gammel*, 259 Neb. 738, 612 N.W.2d 207 (2000).

While several provisions of the Nebraska Child Support Guidelines relevant to the matters at issue in this lawsuit were amended effective September 1, 2002, we rely on those provisions of the guidelines in effect at the time the modification order was entered on August 26, 2002. Paragraph Q of the guidelines stated:

Modification. Application of the child support guidelines which would result in a variation by 10 percent or more, upward or downward, of the current child [\*\*\*230] support obligation, due to financial circumstances which have lasted 3 months and can reasonably be expected to last for an additional 6 months, establishes a rebuttable presumption of a material change of circumstances.

#### Depreciation

John contends, on cross-appeal, that the trial court abused its discretion, depriving him of a just result. John claims the trial court failed to add depreciation claimed on Theresa's federal tax returns back to her income for purposes of calculating child support.

Theresa concedes in her brief that any depreciation associated with rental properties owned [\*\*\*13] by her personally should be added back to her income for purposes of calculating her child support [\*983] obligation. Theresa contends, however, that depreciation reported on her federal tax returns related to her wholly owned S corporations should not be added back to her income because there is no evidence in the record that she is self-employed. Theresa appears to contend that merely holding an ownership interest in an S corporation does not render her "self-employed." Theresa also directs us to the Social Security Administration's definition of self-

employed as someone who reports and pays taxes directly to the Internal Revenue Service rather than to an "employer." Reply brief for appellant at 6. See, also, Soc. Sec. Admin., Pub. No. 05-10022, *If You're Self-Employed* (Jan. 2003). She points out that the W-2 wage and tax statements she received in 1998 and 1999 from Gase Technologies and in 2001 from Lone Star Solutions indicate that Social Security and Medicare taxes were paid by the respective corporations on her behalf. Theresa maintains that these W-2's are evidence that she is an employee and not self-employed. Theresa further contends that the depreciation John seeks to have added [\*\*\*14] back to her income belongs to the corporations and not to her. As such, Theresa argues that corporate depreciation cannot be added back to personal income without first piercing the corporate veil. We address this last contention first.

[5, 6] Subchapter S is a tax status designed to tax corporate income on a pass-through basis to shareholders of a small business corporation. I William H. Painter, *Painter on Close Corporations* § 1.10.1 (Theodore Rinehart & Albert E. Jenner, Jr., eds., 3d ed. 1999). "Since . . . a Subchapter S corporation is not taxed on its earnings, the various income, expense, loss, credit, and other tax items 'pass through' and . . . are taxable to or deductible by shareholders in a manner analogous to that which is applicable to partners." I Painter, *supra*, § 1.10.3 at 1:52. See, I.R.C. §§ 1361 to 1379 (2000); 1 F. Hodge O'Neal & Robert B. Thompson, *O'Neal's Close Corporations* § 2.06 (3d ed. 1998). Thus, although the corporations owned by Theresa are separate legal entities, because subchapter S was elected, their income and expenses for tax purposes are attributable to Theresa. Accordingly, it is not necessary for the corporations [\*\*\*15] to be a party to this action nor is it necessary for us to "pierce the corporate veil" before making a finding that depreciation should be added back to income.

[\*984] [7, 8] Paragraph D of the applicable version of the guidelines provides: "If a party is self-employed, depreciation claimed on tax returns should be added back to income or loss from the business or farm to arrive at an annualized total monthly income." Income for the purpose of child support is not synonymous with taxable income. *Rauch v. Rauch*, 256 Neb. 257, 590 N.W.2d 170 (1999). Simply because "self-employed" may exclude from its definition for tax purposes someone like [\*\*231] Theresa who is the sole shareholder of several S corporations, she is not necessarily excluded for purposes of calculating child support. The guidelines do not limit "self-employed" persons to sole proprietorships or partnerships. In *Glass v. Oeder*, 716 N.E.2d 413 (Ind. 1999), the court treated a shareholder of an S corporation as self-employed. In *Glass*, an action for modification of

child support, the court stated: "We hold that the business expenses of a self-employed parent are to be considered in calculating [\*\*\*16] income for purposes of child support, and income from a wholly-owned subchapter S corporation is to be treated the same as income from a sole proprietorship." 716 N.E.2d at 415. The court further held that "the shareholder of a wholly-owned subchapter S corporation is to be treated the same as a self-employed person operating the business." *Id.*

Likewise, several other jurisdictions have determined depreciation deductions associated with an S corporation must be considered in determining the parent's income for purposes of calculating child support. In *Thill v. Thill*, 26 S.W.3d 199 (Mo. App. 2000), a dissolution action, the Missouri Court of Appeals recognized that the trial court must consider, in its determination of income for purposes of calculating child support, reductions in income for depreciation and § 179 deductions taken by two S corporations. The court explained that because the two corporations at issue chose subchapter S status under the Internal Revenue Code, "they were taxable substantially as is done with a partnership. In that arrangement, no taxes are assessed at the corporate level but rather the income and losses (including depreciation) [\*\*\*17] are passed through to the individual tax returns of the shareholders." 26 S.W.3d at 207. As such, the court continued, "where complicated business and tax status applies, the partnership and Subchapter S income reflected on the individual's [\*985] tax return may not represent the true amount of cash or benefit that may be available to the parent and therefore, for the support of the child." *Id.* See, *Bass v. Bass*, 779 N.E.2d 582 (Ind. App. 2002) (holding that trial court did not abuse its discretion adding depreciation expense deduction back to father's income from S corporation); *Foster v. Foster*, 150 Ohio App. 3d 298, 2002 Ohio 6390, 780 N.E.2d 1041 (2002) (affirming lower court's order adding back to father's income his share of depreciation deduction taken by S corporation in which father owned 50-percent interest). See, also, *Grams v. Grams*, 9 Neb. App. 994, 624 N.W.2d 42 (2001) (requiring sole shareholder of S corporation to add depreciation back to income for purpose of calculating child support).

[9, 10] Based on the foregoing, we conclude that the owner of a wholly owned S corporation is self-employed within the meaning of the [\*\*\*18] guidelines. Accordingly, under the guidelines, we determine that Theresa is self-employed. We have stated that the paramount concern and question in determining child support, whether in the initial marital dissolution action or in the proceedings for modification of decree, is the best interests of the child. *Peter v. Peter*, 262 Neb. 1017, 637 N.W.2d 865 (2002). To allow Theresa to reduce her income by the amount of depreciation deductions passed

through to her from the wholly owned S corporations would work against the best interests of her children. Thus, all depreciation reported on Theresa's income tax returns for the years 1999 through 2001 and all depreciation from Theresa's wholly owned S corporations must be added back to her income in those respective years. This includes any deductions reported in those years pursuant to § 179. See *Gammel v. Gammel*, 259 Neb. 738, 612 N.W.2d 207 (2000) (for purpose [\*\*232] of paragraph D of guidelines, deduction pursuant to § 179 is "depreciation" which should be added back to income or loss in calculating self-employed parent's average monthly income).

#### Retirement Income

Theresa contends that the trial court [\*\*\*19] erred by using John's 2001 income rather than a projected estimate of his 2002 income. Theresa contends, however, that if it was proper for the trial court to rely on John's 2001 income for purposes of calculating child support, the court did not properly calculate that income, because [\*986] the court failed to include John's elective deferrals to a retirement account. We affirm the trial court's use of John's 2001 income, but agree with Theresa that voluntary deferrals to a retirement account should have been added back to John's income.

The trial court assigned to John gross monthly income of approximately \$6,035, which figure apparently derives from box No. 1 of John's 2001 W-2. Box No. 1, entitled "Wages, tips, other compensation," reports 2001 income of \$72,441.20. Theresa contends it was improper for the trial court to rely on box No. 1 income without adding back to it income listed in box No. 12a. Box No. 12a of John's 2001 W-2 reads "D 9509.20." Theresa contends that the instructions on the back side of the W-2 indicate that the entry in box No. 12a of John's 2001 W-2 represents contributions to a voluntary retirement account, which contributions must be added back to income. [\*\*\*20] The instructions portion of the 2001 W-2 wage and tax statement are not a part of the record on appeal.

[11, 12] We have stated that this court will take judicial notice of general rules and regulations established and published by Nebraska state agencies under authority of law. *City of Lincoln v. Central Platte NRD*, 263 Neb. 141, 638 N.W.2d 839 (2002); *Morrissey v. Department of Motor Vehicles*, 264 Neb. 456, 647 N.W.2d 644 (2002). Likewise, we will take judicial notice of rules and regulations established and published by federal agencies under authority of law. A review of the "2001 Instructions for Forms W-2 and W-3 Wage and Tax Statement and Transmittal of Wage and Tax Statements" leads us to conclude that \$9,509.20 reported in box No. 12a, preceded

by "Code D" of John's 2001 W-2, constitutes an elective deferral to either a 401K or a SIMPLE (savings incentive match plan for employees) retirement account from John's gross earnings.

[13] Paragraph E of the applicable version of the guidelines, entitled "Deductions," provided in pertinent part: "The following deductions should be annualized to arrive at monthly net income: . . . (4) Mandatory [\*\*\*21] Retirement. Individual contributions, in a minimum amount required by the plan." The guidelines do not, however, allow a deduction for contributions to retirement plans in excess of the minimum amount required by the plan for purposes of calculating child support. See *Workman v. Workman*, 262 Neb. 373, [\*987] 632 N.W.2d 286 (2001). In *Workman*, we concluded that a self-employed father was entitled to deduct from his income minimum required payments made to a voluntarily established money purchase pension plan, where, once established, the father was required to contribute to the plan. Thus, while the decision to participate in a retirement plan may be voluntary in the first instance, where contributions made to the plan thereafter become mandatory, the minimum contribution required by the plan in effect at the time child support is calculated is deducted from income.

In the instant case, although John's contributions to a 401K or SIMPLE plan are characterized by federal regulation as an [\*\*233] "elective deferral," the contributions may nonetheless be "mandatory" under the guidelines. Because the record on appeal does not reveal whether John's contributions were required by the [\*\*\*22] retirement plan, we remand with directions to the district court to determine what portion, if any, of John's contributions was mandatory within the meaning of the guidelines. All sums which the trial court determines are "voluntary" contributions shall be added back to John's income. Theresa's W-2's in the record on appeal appear to reflect similar elective deferrals to retirement accounts in the amounts of \$7,800 in 1999 and \$2,799.94 in 2001. Because it is unclear whether we have a complete record on appeal, upon remand, the trial court should determine the amount of Theresa's elective deferrals to a retirement account. The trial court should then determine what portion, if any, of those deferrals are voluntary. Those deferrals that the trial court determines are voluntary should be added back to Theresa's income.

#### Averaging Theresa's Income

Theresa next contends the trial court erred by incorrectly determining the amount of her income and concluding that her income had not materially changed. Specifically, Theresa contends that because her income fluctuated between 1999 and 2001, the trial court should

have averaged her income from the prior 3 years to establish her average [\*\*\*23] monthly income, rather than relying on her income as determined during the prior modification hearing.

[14] Paragraph D of the guidelines defines total monthly income as the income of both parties derived from all sources, [\*988] except all means-tested public assistance benefits and payments received for children of prior marriages. The fifth comment to worksheet 1 of the guidelines further provides that "in the event of substantial fluctuations of annual earnings of either party during the immediate past 3 years, the income may be averaged to determine the percent contribution of each parent . . ." Because we conclude depreciation must be added back to Theresa's income, based on the evidence in the record, we conclude that Theresa's income did experience significant fluctuations during the 3 years prior to the hearing. Accordingly, upon remand, we instruct the trial court to average Theresa's income from 1999 through 2001, adding back all depreciation deductions and contributions to voluntary retirement accounts.

#### CONCLUSION

Having considered all of the parties' assignments of error, we affirm in part, and in part reverse and remand with directions as follows:

(1) We remand with [\*\*\*24] respect to the trial court's findings as to the parties' incomes with directions to deter-

mine what portions, if any, of John's deferrals as set forth on his 2001 W-2 and Theresa's deferrals as set forth in the evidence were mandatory within the meaning of the guidelines. Such sums as the trial court finds are voluntary shall be added to that party's income for purposes of calculating child support obligations under the guidelines.

(2) We reverse the trial court's finding as to Theresa's income. We direct the trial court to average Theresa's income from 1999 through 2001. We further direct the trial court to determine Theresa's depreciation from both her personal holdings and the depreciation claimed by her from her wholly owned S corporations. The total of her personal depreciation and the depreciation from the wholly owned S corporations shall then be added to Theresa's income.

(3) The trial court shall determine the child support obligations of the parties [\*\*234] pursuant to the guidelines, using the income figures as amended by the above directions as to deferred income, averaging of Theresa's income, and depreciation. The trial court shall prepare and submit worksheet 1 together with [\*\*\*25] its findings.

[\*989] In our de novo review, we determine that based upon the record in this case, Theresa's remaining assignments of error are without merit.

Affirmed in part, and in part reversed and remanded with directions.

Stephan, J., not participating.